Money for Nothing: Do Business Subsidies Create Jobs or Leave Workers in Dire Straits?

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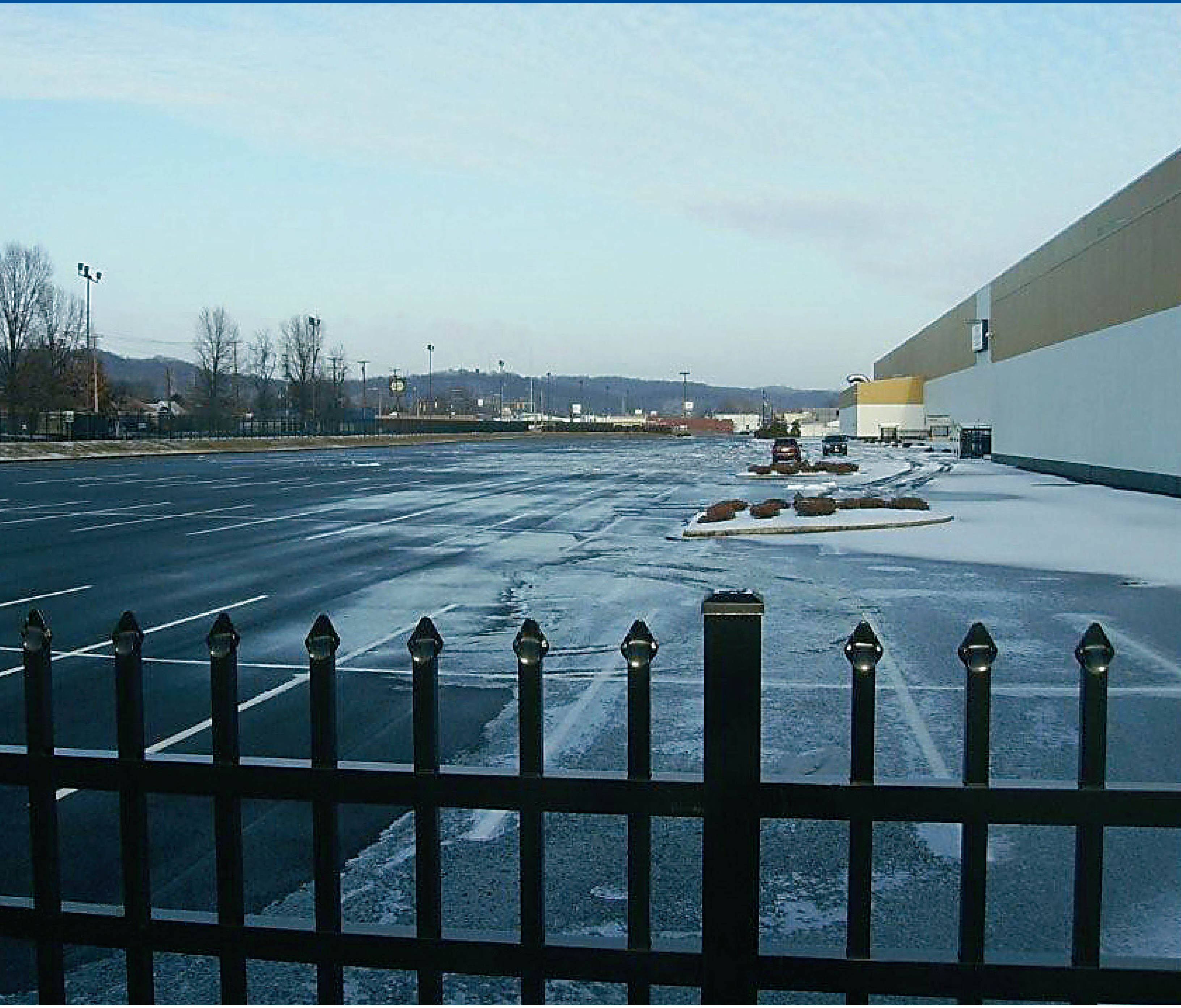

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Executive Summary

West Virginia spends millions of dollars annually on public subsidies to private businesses in hopes of creating good-paying jobs. Yet evidence abounds of private companies cutting jobs after receiving state tax credits and low-interest loans. In extreme cases, corporations have gained or used their subsidies illegally, as in the indictment last year of the former chief executive of Sequelle Communications. More common, however, are companies that simply fail to deliver on their job-creation promises, often without consequences from the public agencies that fund them.

This report examines ways for the state to improve the return on its job-creation investments. Two specific issues are explored: the availability of information to policymakers and the public about business subsidies (transparency), and how well the recipients of business subsidies deliver on their pledges to create jobs (accountability).

The report is not intended to be a comprehensive analysis of all state-sponsored activities that support business development, but rather a focused review of three of the most common subsidies with job-creation requirements: the Economic Opportunity Tax Credit, the Manufacturing Investment Tax Credit, and the West Virginia Economic Development Authority's (WVEDA) low-interest, direct loans.

Using a Subsidy Transparency and Accountability Rating (STAR) Matrix, the report evaluates each subsidy against a set of benchmarks gleaned from national experts and the experience of other states. These include accessible subsidy disclosures, published outcome data, recapture or "claw back" provisions, and a unified state development budget.

Key Findings

- For all three programs, the public can access basic information on subsidy recipients via state agency websites. The programs differ in the depth of information provided and the ease with which it can be accessed online. None of the programs provide information using an online, searchable database.

- Information about the actual number of jobs created is published belatedly or not at all. For example, the state Tax Department releases outcome data only once every three years in aggregate form, without company-specific numbers. WVEDA publishes an annual report on the recipients and amounts of its low-interest loans, but fails to report either the number or quality of jobs actually created under its loan agreements.

- The consequences for subsidy recipients who fail to meet their job-creation requirements are vague. Provisions to recapture funds exist on paper through Tax Department audits and WVEDA loan agreements, but information on the enforcement of these provisions is not published.

- Policymakers lack the information they need on the "big picture" of the state's job-creation goals and investments. Economic development activities span across multiple state agencies, without a unified document that reflects all efforts.

- The problems identified are largely correctable. Actions to improve the transparency and accountability of business subsidies include expanding online subsidy disclosures; collecting, analyzing and publishing in a timely manner information on the number and quality of jobs created; strengthening recapture provisions and publishing their enforcement; and providing to the state legislature a unified development budget on an annual basis.

Improved evaluation and disclosures of business subsidies will improve the success of the state's job-creation investments, as well as earn the trust of the taxpayers who fund them. State policymakers need timely and reliable information about the full range of business subsidies provided, including their costs and impacts. The future vitality of our state economy and its workforce will be well served by such reform.

CHAPTER ONE

West Virginia Jobs On the Line

The need for better jobs in the Mountain State is a compelling one. Even before the national economic downturn, West Virginia incomes were not keeping pace with the cost of raising a family. Health and retirement plans have been steadily eroding. The state's children consistently rank among the poorest in the nation.

The creation of good-paying jobs is a primary aim of most publicly-funded economic development initiatives. The state legislature had this goal in mind when it created the West Virginia Economic Development Authority (WVEDA) in 1962 to "promote, assist, encourage and …provide maximum opportunities for employment."[3]

Yet evidence abounds of private companies cutting jobs after receiving taxpayer-funded subsidies, including the following:

- Interstate Hardwoods of Pocahontas County received WVEDA low-interest loans of $722,260 and up to $150,000 in state tax credits between 2003 and 2006. During this time, the company reported a reduction in its workforce from 215 to 200 employees.[1]

- Tech-Seal Products of Ohio County received a WVEDA low-interest loan for $304,016 in 2003 to expand and create fifteen jobs. The company secured an additional WVEDA loan of $765,000 in 2006. In their 2006 application, Tech-Seal officials revealed they had only 24 employees – 7 fewer than when they secured their original loan three years earlier.[2]

- The Charleston Stamping Plant in Kanawha County received a $15 million low-interest loan from WVEDA in May 2007, in which the state purchased the equipment from the plant's owner and is leasing the equipment back to the company over 23 years. The company installed 24 robots on its assembly lines in April 2007, and had 45 robots as of January 2009. Employment at the facility has dropped to 25 people, down from 1,000 a few years ago.[4]

- Sequelle Communications Alliance, Inc., a now-defunct broadband Internet company in Wood County, received $600,000 from the West Virginia Development Office in 2002.[5] In addition, the Mid-Ohio Valley Regional Council provided $160,000, and the U.S. Department of Agriculture gave them $3.29 million to create as many as 50 good-paying jobs. WVEDA also provided an 80% guarantee insurance policy under their Loan Insurance Program for $300,000 in 2003. The company's former chief executive was indicted in 2008 for misappropriating $4 million in public funds.[6]

Working More, Making Less: The Decline of Job Quality in West Virginia

- Employment in the Mountain State has been on the rise since the mid-1980s. The state boasted 100,000 more jobs in 2007 than it did in 1979. The growth was primarily in service-sector jobs, while goods-producing jobs declined by 46 percent during the same period.

- Only one in five jobs is considered a good-paying job, providing wages and benefits adequate for supporting a family. The state median wage ($14.06) is more than a dollar below the national median ($15.10). Workers without college degrees make less, after inflation, than they did three decades ago.

- Health and pension plans are rapidly disappearing. In 2007, about half of the state's private-sector workers had employer-sponsored health care, and less than half had employer-sponsored pensions. Since 1979, employer-sponsored health coverage fell by 27 percent and pension plans by 23 percent.

Source: *West Virginia Center on Budget and Policy,* The State of Working West Virginia*, 2008*

The state's inability to evaluate the outcomes from its economic development investments has garnered some unwanted national attention. West Virginia recently received an "F" from a national group for the state's lack of transparency and accountability in its business subsidies.

Good Jobs First, which promotes the smart use of business subsidies to attract good-paying jobs, found West Virginia's subsidy disclosures to be among the weakest in the nation.[7]

Purpose and scope of this report

The purpose of this report is to examine ways for the state to improve its return on job-creation investments. Two specific issues will be explored: the availability of information to policymakers and the public about business subsidies (transparency), and how well the recipients of business subsidies deliver on their pledges to create jobs (accountability).

The report examines three key business subsidies authorized by the state legislature as incentives to private businesses to create good-paying jobs. It evaluates the transparency and accountability of each against a set of best practices gleaned from national experts and the experience of other states. These include accessible subsidy disclosures, published outcome data, recapture or "claw back" provisions, and a unified state development budget.

The report is not intended to be a comprehensive analysis of all state-sanctioned activities that support business development, but rather a focused review of three of the most common subsidies with job-creation requirements: the Economic Opportunity Tax Credit, the Manufacturing Investment Tax Credit, and the WVEDA's low-interest loans. A summary of each subsidy is provided in the next section. Additional information can be found on the following websites:

- Tax Department:
  http://www.state.wv.us/taxrev/taxdoc/tsd110.pdf

- WVEDA:
  http://www.wveda.org/program-directloan.html

Getting What the Public Pays For: Transparency and Accountability in Business Subsidies

Transparency and accountability assure that policymakers have the information they need for evaluation and decision-making and that taxpayers have information on public investments and their outcomes. Key measures of transparency and accountability in business subsidies include:

- **Accessible subsidy disclosures:** This includes information about the companies receiving subsidies, along with the amount and purpose of the subsidies, preferably in an online, searchable database. Twenty-seven states, excluding West Virginia, currently provide company-specific, online disclosures of business subsidies.

- **Published outcome data:** This includes company-specific information about the number of jobs actually created, wages and benefits provided, and the demographics of workers hired in order to determine who benefitted from the subsidy. Illinois and Minnesota are considered leaders in conducting outcome analysis of their business subsidy programs.

- **Recapture or "claw-back" provisions:** These are clearly defined and enacted mechanisms for evaluating whether or not subsidy recipients have met their job-creation requirements and for refunding all or part of the subsidy if the requirements were not met.

- **Unified state development budget:** This is an annual report to the legislature of all of the state's economic development investments in one document, including both "on-budget" appropriations and "off-budget" tax credits and exemptions. Several states – including Illinois, New Jersey, Texas and Rhode Island – require preparation of unified development budgets.

CHAPTER TWO

How Business Subsidies Work

Tax credits are the most widely used incentive for economic development in West Virginia. Tax credits are a form of "tax expenditure," or loss of government revenue through laws that allow a special exclusion, exemption, or deduction from gross income or that provides a special credit, preferential tax rate, or deferral of tax liability. Business tax credits are, in effect, subsidies provided through the tax system. Instead of making direct payments to beneficiaries, the government permits certain taxpayers to pay lower taxes than they would otherwise owe.

Tax credits are often favored by state economic development officials with limited resources because they require no up-front money. They are also more likely than loans or grants to deliver the desired results because they require companies to create the jobs before tax credits are claimed.

Economic Opportunity Tax Credit

As of January 2003, the Economic Opportunity Tax Credit allows new or expanding businesses that create 20 new full-time jobs of at least 140 hours per month, to receive a tax credit up to 20 percent of their qualified investment. The credit is based on calculating the useful life of the qualified investment over a 10-year period. The investment can be land, buildings and equipment for employers in manufacturing, information processing, warehousing, non-retail goods distribution, qualified research and development, the relocation of a corporate headquarters, or destination-oriented recreation and tourism.

During tax years 2003 through 2006, claims under the EOTC totalled $4 million. The projected number of new jobs created was 3,234, with an average cost per job of $1,239.

Manufacturing Investment Tax Credit

As of January 2003, manufacturers making qualified investments for expansion or revitalization of industrial facilities within West Virginia can receive a tax credit up to 5 percent of their qualified investments. The credit is based on calculating the useful life of the investment over a 10-year period at a rate of 0.5 percent for each year. Qualified investments include real property improvements and tangible personal property with at least a four-year useful life. Leased property with a minimum lease term of 10 years also qualifies.

The Manufacturing Investment Tax Credit can be used to reduce employer taxes in the following order by no more than 50 percent: business franchise tax, severance tax, and corporate income tax.

During tax years 2003 through 2006, claims filed under the MITC totaled $3.9 million. The projected number of new jobs created was 2,000, with an average cost per job of $1,974.

Direct Loan Program

WVEDA offers low-interest loans to businesses to aid the establishment, revitalization and expansion of industry in the state. Because these loans offer more favorable terms than traditional bank loans, they provide strategic opportunities for the state to advance job creation.

The Direct Loan Program is designed to help businesses create or retain jobs. In particular, the borrower must create or retain one job for every $15,000 of WVEDA participation, up to 45 percent of the total projects investment. Generally, the loan term is 15 years for real estate projects and 5 to 10 years for equipment projects. The minimum loan amount is $50,000, and the maximum is $10 million.

In 2007, WVEDA originated 28 low-interest loans for a total state investment of $39.7 million dollars. The projected number of jobs to be created as a result of these loans was 822, with an average cost per job of $48,297. The actual number of jobs created through the Direct Loan Program has not been published, nor has information about the quality of jobs.

CHAPTER THREE

Subsidy Ratings on Transparency and Accountability

The Subsidy Transparency and Accountability Rating (STAR) Matrix summarizes the degree of transparency and accountability of West Virginia's business subsidy programs. (See Table 1.) The matrix was developed by the West Virginia Center on Budget and Policy after reviewing national research and exemplary practices of other states in administering their subsidy programs.

Illinois is considered a national leader in the transparency and accountability of its business subsidies. In 2003, the Illinois General Assembly passed the Corporate Accountability for Tax Expenditures Act, which includes the following features:

- An annual unified development budget, listing all direct state aid, as well as tax expenditures;
- Standardized information in all subsidy assistance applications, and an electronic tracking system for all state economic development aid. (The tracking system can be found at http://corpacctportal.illinois.gov/);
- Annual progress reports from state-subsidized companies, which are posted electronically in a database that is searchable by company, subsidy type, and year; and
- Recapture provisions in subsidy agreements, as well as public reporting of defaults and recaptures of state subsidies.

For the purposes of this report, the STAR Matrix is used to evaluate West Virginia's Manufacturing Investment Tax Credit (MITC) and Economic Opportunity Tax Credit (EOTC), which are administered by the state Tax Department, and WVEDA's Direct Loan Program. Overall, the analysis reveals that there are significant – and largely correctible – deficiencies in the transparency and accountability of the state's business subsidies, as detailed below.

TABLE 1

Subsidy Transparency and Accountability Rating (STAR) Matrix

Subsidy Disclosures	MITC	EOTC	Direct Loan
Are easily accessible online	★	★	★★
Are published in a timely manner	★	★	★★
Include company-specific data	★★	★★	★★★
Include subsidy type and amount	★	★	★★★
Subsidy Outcomes			
Include number of jobs created	★	★	—
Include quality of jobs created	★	★	—
Specify recapture provisions	★	★	★
Report on recaptures made	—	—	—

Key:

★★★ Exemplary performance on specified measure, with little room for further improvement.

★★ Largely meets specified measure, but further improvement is possible.

★ Some effort has been made, but measure has not been satisfactorily met.

— No evidence available of effort in this area.

Business Tax Credits

The state Tax Department publishes two detailed reports related to business subsidies. The first is the WV Tax Credit Review and Accountability Report,[8] which is published tri-annually on tax credits claimed for each of the three previous tax years. The legislature requires these business tax credits to be reviewed on the following basis: 1.) number of taxpayers claiming the credit; 2.) net number, type and duration of new jobs created by tax credit recipients; 3.) cost of the credit; 4.) cost of the credit per new job created; and 5.) comparison of employment trends for the industry and for tax credit recipients.

The first issue of the report was published in February 2006 and the second in February 2009. The report addresses the five areas specified by the legislature. However, company-specific data are not included. Nor is demographic information included aboutworkers hired to ensure that West Virginians are the primary beneficiaries. Information about redeterminations and recaptures made is also excluded.

The most recent Tax Credit Review and Accountability Report is posted, although not prominently, on the agency's website on a page called "Other Documents" at http://www.state.wv.us/taxrev/publications/taxCreditReviewAndAccountabilityReport.2009.pdf.

The second publication is the West Virginia Tax Credit Disclosure List, also known as the "11-10-5s" report. This report provides the name and address of every business taxpayer receiving a credit. The specific amount of the subsidy, however, is not known. The Tax Department reports this information using the following dollar ranges, 1.) $1 - $50,000; 2.) $50,000 - $100,000; 3.) $100,000 - $250,000; 4.) $250,000 - $500,000; 5.) $500,000 - $1 million; and 6.) more than $1million. The report is not posted on the agency's website.

The state Tax Department has the authority to conduct audits and require refunds when taxpayers claim a credit to which they are not entitled. The extent to which this authority is actually used with the EOTC or MITC is not published information.

The following actions by the state Tax Department would help improve the transparency and accountability of business tax credits:

- Publish the West Virginia Tax Credit Review and Analysis Report and the West Virginia Tax Credit Disclosure List on an annual basis;
- Disclose company-specific information pertaining to the tax credits, including the recipients, amounts and job-related outcomes;
- Publish all reports in an on-line, easily accessible, searchable database similar to the State of Illinois;
- Publish information identifying both loan recipients and amounts of subsidies subject to redetermination and recapture; and
- Support the creation of a unified state development budget.

Direct Loans

WVEDA publishes an annual report identifying the number and amount of low-interest loans, industrial development bonds, and loan insurance issued each year. Low-interest loans are the most common financial incentives offered by the WVEDA.

The loans are documented in the annual report alongside company-specific information about the recipient's current and projected workforce. WVEDA collects this employment information for the federal government's monitoring of its economic development program. This information includes the current number of employees and their wages and benefits; the number of new employees anticipated as a result of the proposed project and their wages and benefits; and plans for jobs retention.

The annual report uses projections of jobs to be created, rather than publishing the actual outcomes of businesses receiving low-interest loans. Only the most recent annual report is available on the agency's website at http://www.wveda.org/annual-report.html. WVEDA loan officers report that loan agreements include recapture provisions for recipients that fail to meet their job-creation requirements. The enforcement of these provisions is not published.

The following actions by WVEDA would help improve the transparency and accountability of the Direct Loan Program:

- Publish company-specific data on the number of jobs actually created, the quality of jobs created, and demographic characteristics of workers employed as a result of the loans;

- Publish information identifying both loan recipients and amounts of subsidies subject to recapture;

- Publish all reports in an on-line, easily accessible, searchable database; and

- Support the creation of a unified state development budget.

CHAPTER FOUR

Reform within the State's Reach

The current economic recession makes it even more important for the state to maximize its job-creation investments. Enhancing transparency and accountability boosts the ability of public officials to make sound decisions and the confidence of taxpayers that their money is being invested wisely. Comprehensive and accessible information on business subsidies would empower the state to be more strategic in its "on-budget" appropriations and "off-budget" tax expenditures for economic development.

Better information would enable policymakers to understand:

- The "big picture" of the state's job-creation goals and investments;
- The number and quality of jobs actually created through business subsidies;
- The demographics (age, sex, race, previous residence) of workers hired in order to determine who is benefiting from the subsidies;
- The extent to which subsidy recipients are generating new economic activity, versus consolidating their activities in new locations;
- The types of industries or sectors of the economy that have been most successful in job creation as a result of business subsidies; and
- The accountability mechanisms that have been enforced when subsidy recipients fail to meet their job-creation requirements.

The deficiencies in the state's business subsidy programs, as noted in this report, are largely correctable. Policy options that would advance the transparency and accountability of business subsidies and provide critical information about their effectiveness include:

- **Require all state agencies to disclose company-specific data on business subsidies, as well as their job creation outcomes.** Such disclosure would improve economic development decision-making, avoid wasteful and ineffective spending, and improve taxpayer confidence. The information should be accessible through an up-to-date, online, searchable database.
- **Require specific deadlines for state agencies to publish outcome reports on business subsidies.** For example, the Tax Department currently issues its annual tax credit disclosure reports only once every three years. One option is to mandate the reporting of all claims by June 30th of each fiscal year for the previous year's tax credits. These tax credit reports should identify specific credits claimed by company name, as well as the number of jobs created and their wage and benefit information.
- **Require economic development agencies to enforce recapture or "claw-back" provisions for companies that fail to meet job creation or benefit agreements.** Current state practice allows for ineffective companies to continue receiving state subsidies while failing to produce good-paying jobs. Recapture provisions should be clearly stated in all business subsidy agreements, and their enforcement should be publicly disclosed.
- **Require a unified development budget for legislative approval at the beginning of each legislative session.** This outline of all economic development activity at the state, regional, and local level would enable policymakers to target the state's resources to advance its economic development goals. In addition, a unified development budget would elevate the importance of creating good-paying jobs as a primary focus of economic development in West Virginia.

Improved evaluation and disclosures of business subsidies will improve the success of the state's job-creation investments, as well as earn the trust of the taxpayers who fund them. State policymakers need timely and reliable information about the full range of business subsidies provided, including their costs and impacts. The future vitality of our state economy and its workforce will be well served by such reform.

End Notes

1 West Virginia Economic Development Authority Annual Reports for 2003 and 2006; West Virginia 2003 Tax Credit Disclosure List.

2 West Virginia Economic Development Authority Annual Reports for 2003 and 2006.

3 WV Code 31-15-3, West Virginia Economic Development Authority

4 Telephone conversation with secretary to John Wise, Plant Manager, 01/05/09.

5 The WV Development Office recaptured part of its investment in equipment recovered from this company valued between $450,000 – $500,000. Telephone interview with Bobby Lewis, West Virginia Development Office, 01/08/09.

6 Bauer, Brad. "Former Sequelle CEO indicted." Marietta, Ohio: *Marietta Times*, August 8, 2008.

7 Mattera, Phillip, Karla Walter, Julie Farb Blain, and Michelle Lee. "The State of State Disclosure: An Evaluation of Online Public Information About Economic Development Subsidies, Procurement Contracts and Lobbying Activities." Washington, D.C.: Good Jobs First, November 2007. http://www.goodjobsfirst.org/news/article.cfm?id=375

8 WV Code, Sections 11-13Q-20, 11-13R-11, 11-13S-10, 11013U-8.

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